



OECD Investment Policy Reviews: Mozambique

Executive Summary and Recommendations



The Ministry of Planning and Development of Mozambique partnered with the NEPAD-OECD Africa Investment Initiative over 2011-2013 to undertake an Investment Policy Review, with the support of the Government of Finland, based on the OECD Policy Framework for Investment (PFI).

This document has benefited from several fact-finding missions in Mozambique, as well as from inputs from an All-Stakeholder Launching Event hosted by MPD in Maputo on 28 March 2013. The content and key recommendations of the Review have been approved by Government and all stakeholders as of April 2013.

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FOREWORD

The Investment Policy Review of Mozambique is one of five reviews carried out in member states of the Southern African Development Community (SADC) on the basis of the OECD Policy Framework for Investment (PFI). Undertaken by the NEPAD-OECD Africa Investment Initiative in the context of the “*Unlocking Investment Potential in Southern Africa*” programme with the support of Finland, it reflects the growing co-operation between the OECD and its African partners.

The Review is the result of a self-assessment undertaken by a national task force composed of government agencies, the private sector and civil society established by the government of Mozambique and headed by the Ministry of Planning and Development (MPD) in collaboration with the Ministry of Finance and the Ministry of Industry and Commerce. The review process was launched during an inter-agency workshop in December 2010 in Maputo, which gathered 50 participants from various ministries, technical institutions, development agencies, private sector and civil society. Fifteen different government agencies were involved in responding to the PFI questionnaire and participated in all-stakeholder meetings as well as bilateral fact-finding sessions in July 2011 and May 2012. The findings of the Review were presented to all stakeholders and discussed in depth in March 2013, under the chairmanship of Adriano Ubisse (National Director for Investment and Cooperation, MPD).

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TABLE OF CONTENTS

| | |
|---|----|
| EXECUTIVE SUMMARY | 3 |
| Key policy recommendations | 5 |
| CHAPTER I: OVERVIEW OF INVESTMENT POLICY CHALLENGES AND RECOMMENDATIONS FOR MOZAMBIQUE | 7 |
| 1.1 Document summary | 8 |
| 1.2 Macroeconomic environment..... | 8 |
| 1.3 Investment policy context | 13 |
| 1.4 Investment trends | 15 |
| 1.5 Central policy challenges | 18 |
| 1.6 Investment policy options to prioritise..... | 22 |
| 1.7 Addressing these challenges in the context of an OECD Investment Policy Review | 28 |
| References..... | 29 |

EXECUTIVE SUMMARY

Market-based economic policies have been an important factor in stimulating economic development in Mozambique over the past 15 years, securing one of the highest growth rates of African non-oil economies during this period. Since the early 1990s the country has moved away from central planning, created the Mozambique Investment Promotion Centre (CPI) and reformed its investment code to strengthen investors' rights. This momentum is upheld today and since 2013 CPI is elaborating a national investment promotion strategy together with sector-specific investment promotion agencies.

However the Mozambican economy faces somewhat of a mis-match between growth and investment trends. Real GDP growth has been consistent and strong since 2002 (at over 7.5% annually), driven mainly by agriculture and by construction and tourism services. Yet agriculture absorbs only 10% of private investment, and expansion and value-addition beyond the cash-crop sectors remain hindered by inadequate infrastructure, commercial networks, and financing. By contrast the mining sector, which provided only 1% of GDP over 2010-2012, concentrates the vast majority of export revenues and of FDI.

Mozambique has therefore historically depended on 'mega-projects' in the extractive sector for its revenue and foreign exchange – and particularly on aluminium, which has been subject to large international price swings over the past few years. The country is also entering a 'coal boom', and the opening of multiple new mining concessions caused FDI inflows to double over 2011. Nevertheless the share of FDI into non-mega projects (mainly in the agriculture, industry and tourism sectors) has gradually risen to 45% over the past five years – an encouraging trend which Mozambique could seek to further encourage in order to increase the spill-overs of investment across the broader domestic economy.

The legal framework for investment remains difficult to decipher and investor protection standards could be strengthened. This is particularly the case for intellectual property rights, access to land, protection from expropriation and the resolution of disputes. Moreover several sectors of the economy are restricted to foreign participation, and pre-conditioning all guarantees of the Investment Law on the possession of investment licenses tends to disadvantage SMEs. Many of these persisting gaps and contradictions in Mozambique's investment policy framework are exacerbated by poorly-managed communication and weak feedback mechanisms between public and private sectors.

Processes for land registration and access pose an especially complex barrier for all investors. Land-use rights (DUATs) must be secured through multiple procedures involving disparate institutions, and procedures for community consultation and compensation are frequently protracted and costly. In addition land tenure rights are insufficiently secure as the DUAT can be revoked at any point if investors are deemed to contravene agreed land exploitation plans. Land registry and cadastre issues pose an obstacle not only for potential investors but also for investment promotion bodies in their efforts to identify and market available investment opportunities.

Inadequate infrastructure hinders business operations, and demand from large-scale consumers and export markets takes precedence over domestic needs. Electricity and transport infrastructure have traditionally served the needs of mega-projects and of consumers abroad. By contrast only 14% of the population has access to electricity. To meet the anticipated mining and exports boom, large investors are now looking to develop their supporting infrastructure. These investments by mining and other companies present significant network expansion opportunities, but may bring few benefits for the local population if operated as enclaves; they will therefore require careful co-ordination by Government.

Key policy recommendations

Policies to strengthen and clarify the legal framework for investment

- Group all sector restrictions on FDI within a regularly updated negative list. This would detail all activities for which special treatment is provided to Mozambican nationals, or where foreign participation is limited to specific thresholds.
- Clarify the measures that are considered as national interest in cases of expropriation and nationalisation, and facilitate investor access to international arbitration.
- Consider eliminating investment licenses, or extending the scope of the Investment Law beyond those investors that have obtained investment licenses.

Policies to facilitate access to land for investors

- Revive and adequately maintain the electronic land registry and cadastre (LMIS) so as to accelerate land registration processes.
- Simplify procedures for community consultation and investor access to land use rights (DUATs) – notably by reducing the number of agency approvals necessary, and reviewing the distinction between a provisional and a definitive DUAT.
- Enhance security of land tenure by providing greater protection from expropriation within the DUAT, and by ameliorating the efficacy of the court system in adjudicating land disputes.

Policies to better promote and facilitate investment

- Establish a mechanism for systematic cost-benefit analysis of tax incentives for investment (including evaluation of the impact of Special Economic Zones); this analysis should consider alternative uses of the forgone fiscal revenue – notably structural policies to enhance infrastructure and human resources for investment attraction.
- Formalise mechanisms for collaboration among investment promotion agencies (CPI, INATUR, CEPAGRI, IPEX) and strengthen their role as channels of communication between government and the business community. The design, implementation and monitoring of forthcoming investment and export promotion strategies should closely involve all of these bodies.
- Provide more structured government support for private sector efforts to foster business linkages between small-scale domestic enterprises and larger investors – both in the extractive sector (through mining development agreements), and by extending targeted linkage programmes to more labour-intensive sectors (such as agriculture or tourism).

Policies to meet domestic infrastructure needs

- Co-ordinate infrastructure investments by mining companies so as to enhance coherence with spatial development plans, build on joint economies of scale, and cater to domestic needs by extending infrastructure services beyond the areas immediately covered by the mining projects.

- Strengthen the regulatory framework for procurement and PPPs in infrastructure and empower procurement entities and PPP Units to better prepare and package projects for national as well as cross-border infrastructure.
- Empower sectoral infrastructure regulators not only for the pricing of public utility services, but for monitoring project implementation and revising privileges enjoyed by state-owned enterprises across infrastructure sub-sectors.

CHAPTER I: OVERVIEW OF INVESTMENT POLICY CHALLENGES AND RECOMMENDATIONS FOR MOZAMBIQUE

Mozambique has made marked progress in recent decades in terms of liberalization of its economy and improvement of its investment framework. This overview first provides a short description of the macroeconomic environment and investment policy context in Mozambique, taking stock of Mozambique's fundamental investment, privatization and business reforms. Second, it gives an overview of investment and growth trends over the last two decades. This helps shed light on dominant policy challenges faced by Mozambique in attracting investment across all economic sectors. Among other obstacles, many aspects of the investment policy framework remain insufficiently transparent and do not provide effective safeguards of policy predictability for both foreign and domestic investors. After years of successfully attracting investment into capital-intensive mega-projects, Mozambique now needs to diversify in more labour-intensive sectors such as agriculture and tourism, and to also increase business linkages in the mega-project sectors themselves. In order to facilitate this, many large infrastructure gaps will need to be addressed. Finally, this overview chapter provides recommendations for policy options to prioritise. These recommendations should assist the Government of Mozambique in improving the general investment climate, notably so as to enhance its diversification strategy and stimulate greater investment in infrastructure.

1.1 Document summary

This chapter first provides a short description of the **macroeconomic environment and investment policy context** in Mozambique. Mozambique today has one of the highest growth rates of Africa's non-oil economies, averaging 7.5% since the turn of the millennium. The country has engaged in considerable economic reform since its emergence from civil war in 1992, with substantial support from development partners. The pace of reform and modernization has especially picked up since the mid-2000's, numerous investment policy reforms having been recently introduced and others being in the process of definition and implementation. Mozambique has undertaken many efforts to make it easier for enterprises to do business, and to increase the country's attractiveness for foreign and domestic investment – especially in the mining sector. Yet poverty and unemployment rates remain high, and in many other economic sectors Mozambique remains outperformed by neighbouring countries in the Southern African region. Moreover Mozambique's doing business performance (as calculated by the World Bank Doing Business indicators) has stagnated, and most recently declined.

Second, this chapter gives an overview of **investment and growth trends** over the last two decades. This illustrates that the Mozambican investment policy framework has generally encouraged both domestic and international private investment, particularly in larger, formal industries and most effectively in the extractive industries. It also highlights Mozambique's recognised need to diversify its economy towards more labour-intensive sectors such as agriculture and tourism; this could enhance employment opportunities, better distribute economic growth, and reduce the current variability in export revenues and FDI inflows.

Third, the document identifies **dominant policy challenges** faced by Mozambique in attracting investment across all economic sectors. Among other obstacles, many dimensions of the investment policy framework remain insufficiently transparent and do not provide effective safeguards of policy predictability for both foreign and domestic investors. Access to land is subject to complicated procedures, and provisions for investor protection are not clearly outlined within a common legal instrument. In the field of investment promotion, there is a need for more systematic analysis of the impact of existing investment incentives, including in special economic zones; there is also unexploited potential for business linkages in the mining sector, and mechanisms for investor-State communication are weak and under-utilised. Finally the infrastructure gaps across all economic sectors remain vast, particularly as concerns the energy sub-sector.

Finally, this chapter suggests several **associated policy options** to address these obstacles. These policy options aim to enable Mozambique to better attract and leverage the role of foreign and domestic investment in the economy, so as to: better share the dividends of growth from the mining industry; stimulate competitiveness and investment attraction in other sectors of the economy; and enable the Government to meet the employment and growth objectives of the current poverty reduction strategy (PARPA, 2011-2014).

1.2 Macroeconomic environment

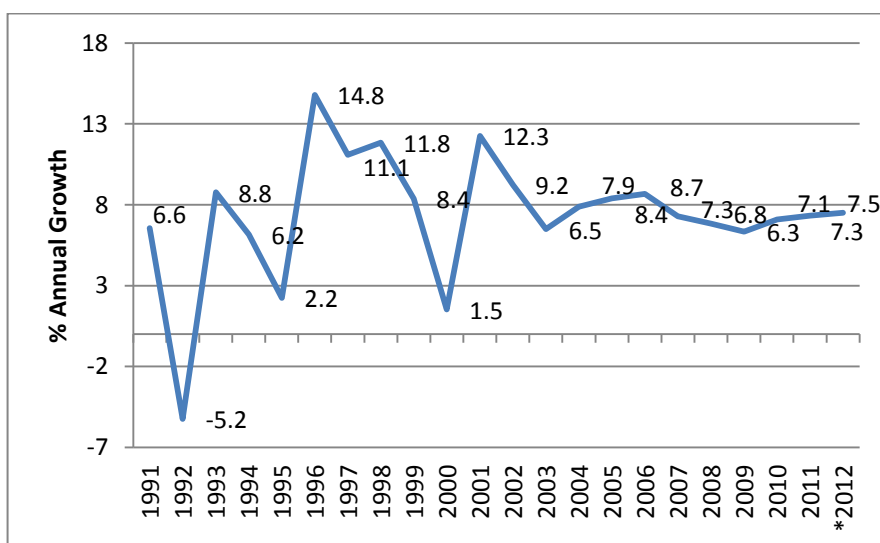
Trends and composition of growth since independence

Following Mozambique's independence from Portugal in 1975, from 1977 to 1992 the country was embroiled in a protracted civil war. By the time of the General Peace Accords of 1992 the country ranked among the poorest in the world, with very low social and economic indicators. The planned economy approach adopted under the presidency of Samora Machel was ended in 1987 with the **Economic Recovery Plan** (ERP), which included measures to stimulate the private sector and was reinforced in 1990 by legislation and the enactment of a new constitution providing for a multiparty political system, market-

based economy, and free elections. The transition to a more liberalised economy was therefore underway before the end of the war.

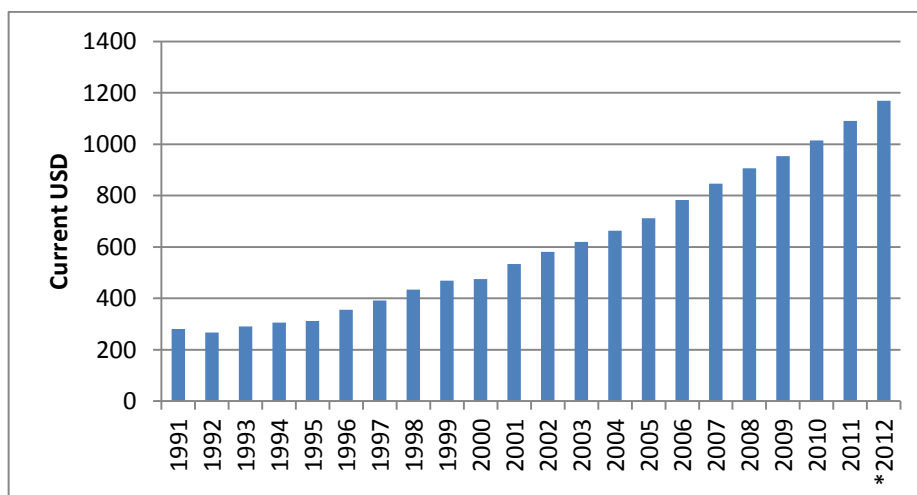
Throughout the 1990s and with considerable support from the World Bank, the International Monetary Fund and other development partners, **a burst of economic reform took place** with a focus on moving away from central planning, engaging in privatisation and setting up a modern judicial and banking system. The investment code was reformed in June 1993 to clarify investors' rights and obligations, as well as fiscal and customs regulations. Mozambique's market-based economic policies have proven to be an important factor in national economic growth over the past 15 years, producing one of the highest growth rates of African non-oil economies during this period. Since 2002 annual real GDP growth has averaged over 7.5% (Figure 1.1). While GDP per capita has not experienced a continuous increase, overall the trend is also visibly positive (Figure 1.2).

Figure 1.1: Annual percentage GDP growth in Mozambique, 1991-2012



Source: IMF World Economic Outlook, 2013 (* Note: 2012 figures are estimated)

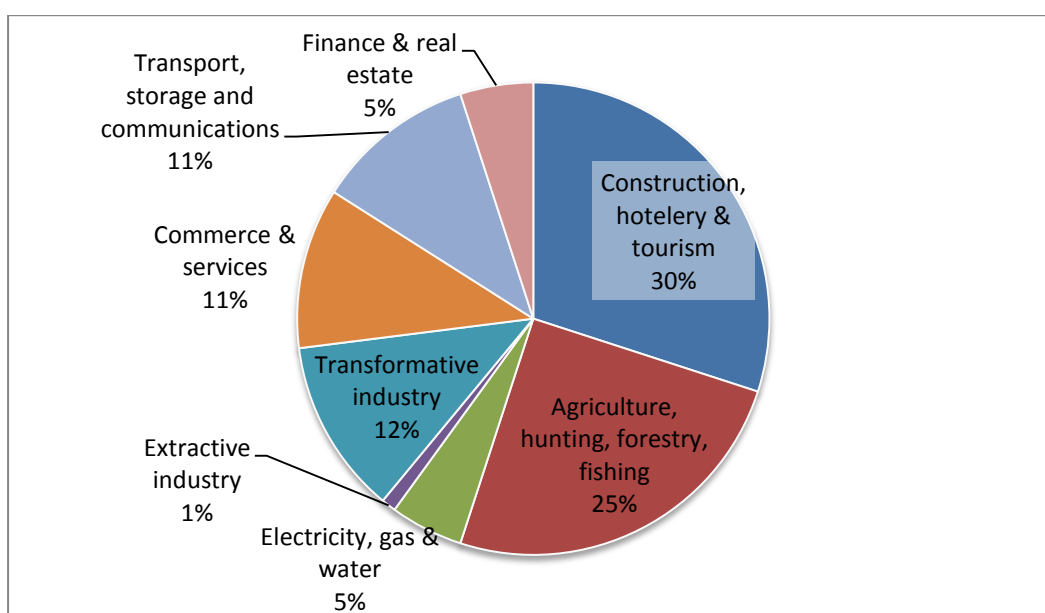
Figure 1.2: GDP per capita in Mozambique (current USD at PPP), 1991-2012



Source: IMF World Economic Outlook, 2013 (* Note: 2012 figures are estimated)

GDP remains driven by agriculture (mainly tobacco, sugar, cotton and cashews, accounting for 25% of GDP in the first quarter of 2012, Figure 1.3), and by services, which include construction and tourism (30%), commercial services (11%), transport and communications (11%), and finance and real estate (5%). Agriculture therefore accounts for 80% of total employment in the country, and services for at least 13% (and probably much more if informal employment were also accounted for). The share of agriculture in total output has nonetheless declined since 1996, whereas services and industry have reached double-digit growth since 2003 (particularly the gas, electricity and construction sectors).¹ Meanwhile, although the mining sector (particularly aluminium) contributes to the vast majority of export revenues and also concentrates most of FDI flows (see following sections), it provides a very small share of GDP (only 1% over 2010-2012). This contrast suggests that, unlike for agriculture and services, revenues from the mining industry are insufficiently spread throughout the economy and therefore do not substantially contribute to GDP growth.

Figure 1.3: Mozambique GDP Composition, 2012 (Quarter 1)



Source: Bank of Mozambique, July 2012

Poverty reduction and the role of ‘mega-projects’

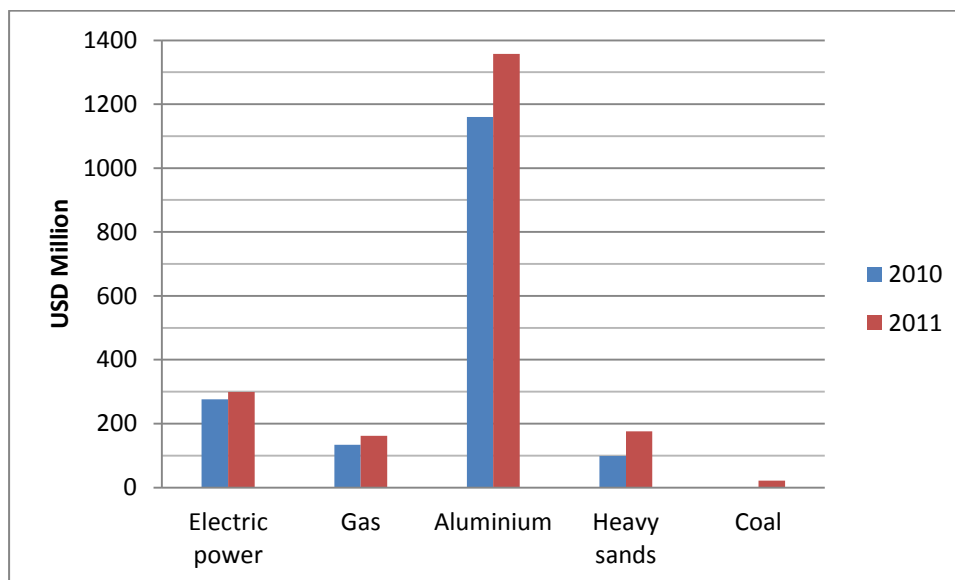
In spite of encouraging growth rates in recent years, poverty remains a central challenge in Mozambique. While the poverty rate declined from 69.4% of the population in 1997 to 55% in 2010, recent survey data shows that poverty alleviation is stagnating and that regional disparities remain serious. Most Millennium Development Goals are unlikely to be achieved by 2015, and demonstrations and riots have emerged in 2008 and 2010 as a reaction to rising food prices. This has pushed the Government to reconsider its diversification strategy from the angle of poverty reduction: the 2011-2014 **Action Plan for the Reduction of Absolute Poverty** (PARPA II) evokes a growth model based on further developing extractive industries in the interest of creating more domestic employment opportunities. Mining projects are for example generating investment in the transport sector and in ICT, which continues to be the second-largest source of economic growth after agriculture.² PARPA II also emphasises the importance of diversifying investment partners (notably towards Brazil, China and India).

Government’s ‘new growth model’ thus explicitly places focus on further diversification *within* the extractive industries as a means of reducing poverty and generating employment – that is, creating more linkages between extractive mega-projects and the rest of the economy, thereby using mega-projects as a stimulus for growth in multiple other economic sectors. In this context the government is pushing for further momentum in creating **Special Economic Zones (SEZs)** and **Industrial Free Zones (IFZs)** in the extractive industries – especially for aluminium, but also increasingly for the extraction of gas, coal, and some oil. Close to half of the provisions in the 2009 Regulations of the Investment Law are indeed dedicated to licensing procedures and provisions for the establishment of these various economic zones. These zones (first created around the Mozal Aluminium Smelter, and more recently extended to the Nacala are) were intended to develop linkages between multinational and domestic enterprises.

Export composition and trade balance

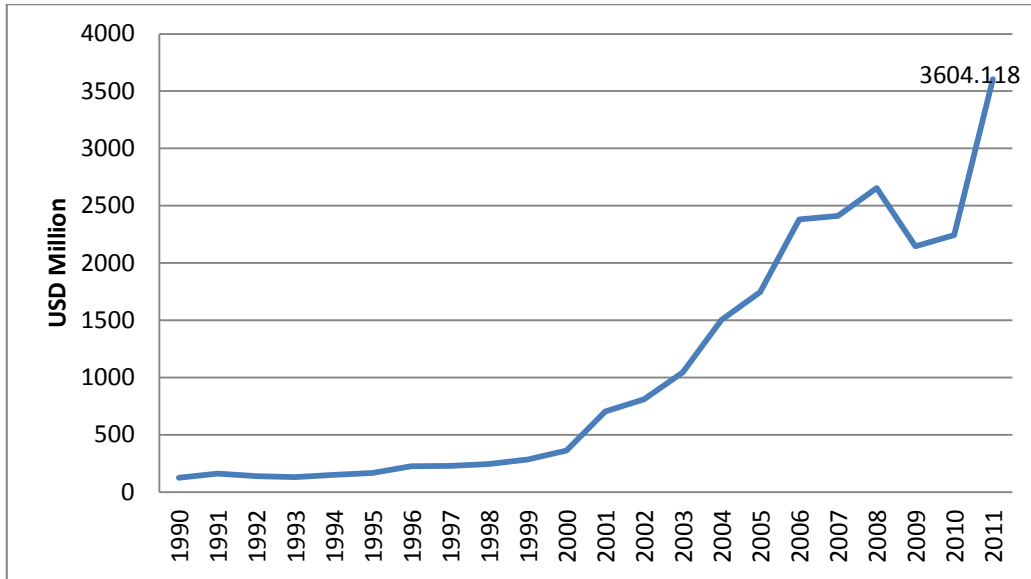
In 2011, 72.6% of Mozambique’s exports originated from mega-projects, especially in the **aluminium industry** (but with a strong growth in exports of electric power, coal and heavy sands as well – Figure 1.4).³ The remaining 27.4% of exports are centred in the agricultural sector, with tobacco and sugar as the leading industries (7% and 4% respectively). Close to 50% of export revenues are thus concentrated in aluminium, a commodity subject to wide price fluctuations. This strongly increases the vulnerability of the Mozambican economy to external shocks. Mozambican exports suffered from a reduction in aluminium demand and price in 2009 (when aluminium prices contracted by 14.9% - this dip is visible in Figure 1.5 below), following which recovery on the minerals markets has generated a 48.9% increase in aluminium exports over 2009-11.⁴ Over 2007-2011 the country’s main export markets have been the EU (especially the Netherlands, with 52% of total exports), South Africa (18%), other SADC countries (6%), and China (2%).

Figure 1.4: Composition of Exports by Mega-projects, 2011



Source: Bank of Mozambique, June 2012

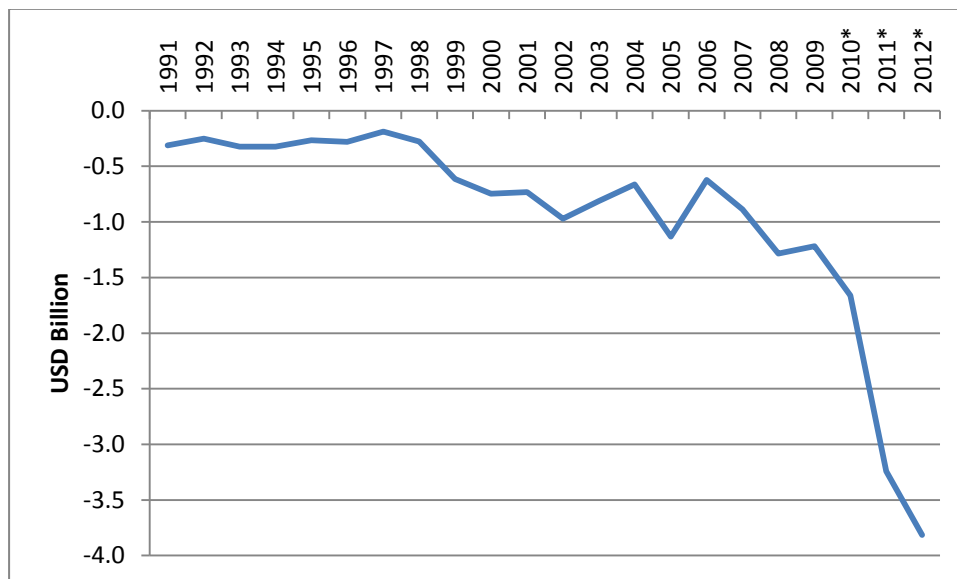
Figure 1.5 Export of goods and services, 1990-2011



Source: UNCTAD Stat, 2012

Such variability in export revenues may threaten the stability of Mozambique’s **current account balance** (which has been in steep decline, especially since 2007 – Figure 1.6), especially since the Mozambican currency is structurally fragile and therefore relies on safeguard mechanisms put in place by the government. The Bank of Mozambique attributes the particularly strong decline of the current account in 2011 to an increase in imports of machinery and construction services for expanding or recently-launched mega-projects, especially in Tete and Cabo Delgado provinces.⁵ In addition gross fixed capital formation (GfCF, considered below) could likely benefit from more predictable export and growth trends.

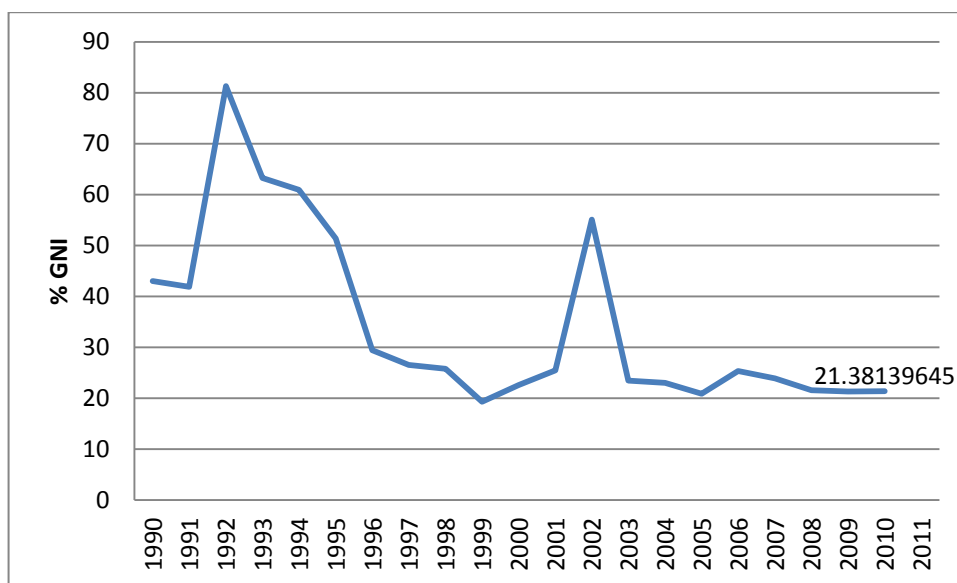
Figure 1.6 Current Account balance (BoP), 1990-2012



Source: IMF World Economic Outlook, 2013 (* Note: 2010-2012 figures are estimated)

Further compounding this fragility, Mozambique’s national budget remains excessively **dependent on external aid**. Substantial progress has been made recently, ODA’s contribution to the State Budget having been reduced from 56% in 2008 to 40% in 2012, with 31% projected in 2014.⁶ Likewise, while ODA flows made up as much as 81% of gross national income (GNI) in 1992, it has averaged 22% over 2005-2010 (Figure 1.7). Mozambique is currently working on a medium-term debt strategy (MTDS) that should be conducive for further improvements. Nonetheless this high reliance on aid for national expenditures and thus public investment places important caveats on the country’s strong average growth rate since 2002.

Figure 1.7 Net ODA received, % of Gross National Income, 1990-2010



Source: World DataBank, 2012

1.3 Investment policy context

Over the past two decades (and particularly since 2005 and the advent of the Guebuza administration), Mozambique’s **economic framework** has undergone significant changes in the basic commercial code, labour law, fiscal regime of the mining sector, public procurement, tax code, public financial management, foreign exchange, public-private partnerships, commerce, intellectual property rights, as well as in the establishment of institutions to implement policy objectives.

Progress has been made in terms of **foreign ownership rights**, for instance by removing restrictions of the 1990 Constitution and simplifying the conditions for foreign investment. Overall, the investment framework in Mozambique is today governed by two pieces of legislation: the Investment Law 3/1993, and its updated Regulations, the Decree 43/2009. This framework does not however cover investments in petroleum, natural gas and mining, which are governed by separate legislation. The objective of the **Investment Law**, when it was promulgated in 1993, was to be in line with the Economic Recovery Plan and the then new Constitution. It reflected the will of the government to conduct open economic policy without distinctions based on investors’ origin, and to provide all investors with equal rights and obligations. Among others, the Investment Law offers protection guarantees and includes provisions on the resolution of disputes. Although neither national nor foreign investors are obliged to comply with the Investment Law, only investors that follow the Law’s provisions will have access to “investment licenses” from the CPI. In turn, while this license is not mandatory for business operations, the benefits and provisions of the Investment Law apply only to those investors who hold it.

Decree 43/2009, meanwhile, is an update of earlier Regulations (Decree 14/93) that were related to the Investment Law. It abrogates all the provisions of Decree 14/93, except for Article 4 pertaining to the creation of the Mozambique Investment Promotion Centre (CPI). Among others, the new Decree defines the regulatory framework for investment and establishment in SEZs and IFZs, as well as several other types of special economic zones. Such zones nevertheless existed before enactment of the 2009 Regulations: in 1999 Mozambique set up its first **Industrial Free Zone Council**, which approved the Mozal aluminium smelter free enterprise zone (followed by Mozal II in 2001). On the policymaking front, the **Investment Council** (*Conselho de Investimento*) was created by Decree 44/2009 as the government body at the ministerial level responsible for designing policies to promote and attract investments, and for submitting these to the Council of Ministers.

As for **investment promotion**, the CPI took over operations as the national investment promotion agency in 1992 (replacing the earlier Office for Promotion of Foreign Investment). CPI, together with the Office for Accelerated Economic Development Zones (GAZEDA), has been put in charge of implementing the 2008-2012 ‘Strategy for improving the business environment’. This Strategy follows in the steps of the 2008 Decree on Simplified Licensing, and shares the latter’s objective of simplifying and improving doing business. In 2009 the Code of Fiscal Benefits additionally harmonised investment incentives (accessible to international investments with a value of at least USD 100 000), although some specific sectors continue to operate under separate benefit laws. Most recently, in the course of 2013 CPI is elaborating a **national investment promotion strategy** together with other sector-specific investment promotion agencies (including CEPAGRI for agriculture and INATUR for tourism).

Mozambique’s parastatals have also been progressively privatized, though the process remains slow and carefully controlled.⁷ By May 2011 more than 1 200 state-owned enterprises (mostly small) had been privatized, and preparations for partial privatization and/or sector liberalization were underway for the remaining parastatals, including in telecommunications, electricity, ports, and the railroads. More efforts remain necessary to accelerate this process, and also to improve the efficiency of industries that remain state-owned. As part of the country’s new growth strategy the government is additionally promoting Public Private Partnerships, especially in transport via development corridors.⁸ Mozambique promulgated a new PPP law in May 2011 (the Law on PPPs, Large-Scale Projects and Business Concessions), and the associated Regulations were published in July 2012. Government is also considering developing a separate law for small-scale and municipal PPPs, and a new procurement law has also come into force. One of the stated objectives of the latter is to ensure that large investment projects multiply linkages with the local economy, thus better contributing to wealth and employment creation.⁹

The past decades of reforms have therefore positively re-oriented the trajectory of economic growth and development in Mozambique; nonetheless **policy implementation** is often weak, as several arms of the government remain committed to a regulated economy or lack the requisite technical capacity. There can therefore be a gap between promulgation of policy and its comprehension and operationalisation – by individuals and corporate citizens, as well as by government staff overseeing policy implementation. Similar shortfalls are also noted by UNCTAD in its review of Mozambique’s investment framework, which remarks that, “regulatory approaches akin to a planned economy continue to transpire in the investment framework, which leans towards giving a relatively heavy-handed and intrusive role to the regulator”.¹⁰ This gap between investment policy intent and practice is reflected in the annual results of the World Bank’s *Doing Business Reports*. The overall standing of Mozambique dropped by seven places in 2012 compared to the previous year (to 139 out of 183 countries surveyed); meanwhile although Mozambique had improved by four places overall in 2011, improvements were concentrated in only one of nine surveyed areas: ‘starting a business’ (Table 2.1, Chapter 2). Given this uneven progress, the government’s aim of having the best Doing Business ranking in SADC by 2015 (as was announced with donors and other development partners in 2007, and which would imply a ranking in the twenties) remains far out of reach.

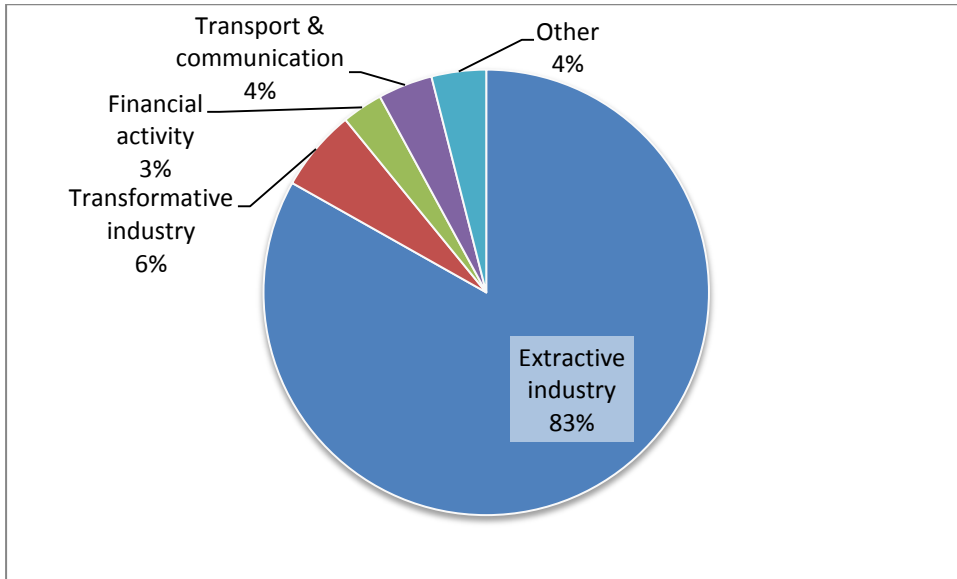
1.4 Investment trends

Foreign direct investment (FDI) inflows to Mozambique increased only very gradually in the five years following the 1992 peace agreement. However in the early 2000's two mega-projects – the Mozal project for aluminium, and the Sasol project in the gas sector – created a landmark change in these trends and catalyzed subsequent FDI inflows. These inflows have been mostly **export-oriented and concentrated in mining** (aluminium and increasingly coal, driven by the mines in Tete Province), and in oil and gas. In 2011 extractive industries thus accounted for 83.3% of total FDI inflows (Figure 1.8). Construction and manufacturing also attract a substantial share of FDI, but remain heavily dependent on the extractive sectors: over 90% of activity in manufacturing results from inflows linked to the Mozal aluminium smelter. Rising aluminium prices therefore largely explain the considerable expansion in FDI since 2009, and the opening of multiple new coal and aluminium mining concessions triggered a doubling of FDI inflows over 2011 (Figure 1.9). In 2011 most of this FDI originated from Brazil (43%), Mauritius (22%), South Africa (6%, including investments in agriculture and agro-industry), and the EU.¹¹

Meanwhile **agriculture**, despite being the primary contributor to GDP composition and employment creation, absorbs only 10% of private investment (of which 90% is geared to export-oriented crops, including tobacco, cotton, cashews, prawns, sugar, and timber). Although Mozambique has large amounts of unexploited arable land, expansion and value-addition in small-scale agriculture remain hindered by inadequate infrastructure, commercial networks, and financing. Coherent export development initiatives have been scarce in the agricultural sector, and fuel and mineral exports have therefore experienced much faster growth compared to agricultural exports over the past two decades. As a result, and because most food production remains at the subsistence level, Mozambique has long depended on imports for food, oil and basic manufactured goods. Its main imports are thus: manufactured goods (55% of imports in 2009, including vehicles, textiles, and especially machinery and equipment for use as mega-project inputs); foodstuffs and other agricultural products (16.62%); and fuel and mining products (close to 16%, these being mostly production inputs such as chemicals and metal). In 2011 mega-projects accounted for 36.9% of total imported goods.¹² These imports are mainly supplied by South Africa and the EU, particularly the Netherlands and Portugal. Mozambique has nonetheless been attempting to reduce this reliance especially in recent years, via steady increases in local production and export diversification in agriculture and manufacturing.¹³

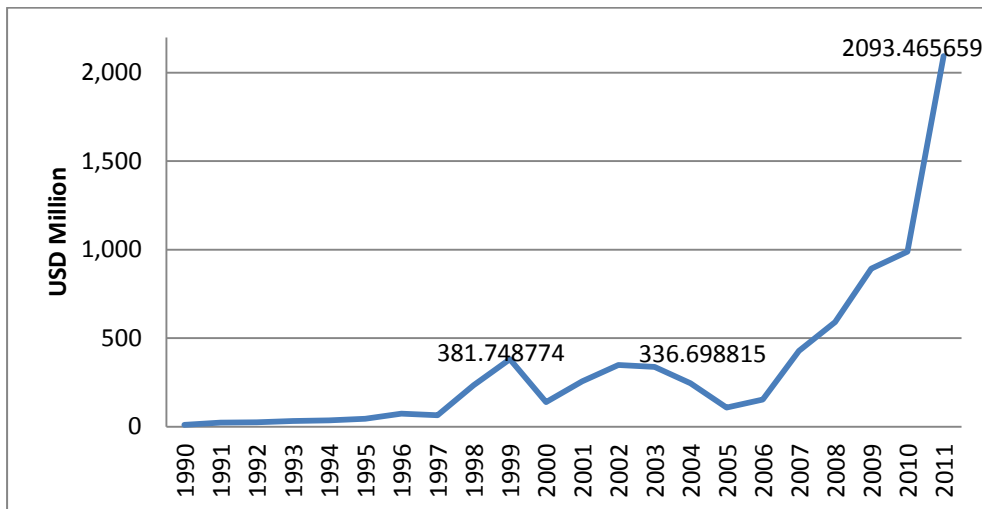
More recently **FDI has therefore been rising in agriculture**, where some mega-projects are also underway – especially in vegetable oils and bio-fuel processing. Over the past five years FDI in non-mega projects (mainly in agriculture, industry and tourism) has in fact doubled, reaching almost 45% of FDI inflows. A central objective of the PARPA for 2011-2014 is to increase productivity in the agricultural sector, and Government has developed an Agricultural Development Plan (PEDSA, which is rooted in the country's 2008-2012 Green Revolution Strategy)¹⁴ as well as a Strategic Biofuel Policy (currently in its 2009-2015 pilot phase). In its review of Mozambique's investment framework, UNCTAD thus describes FDI outside of mega-projects as an “underestimated factor” in the country.¹⁵ This encouraging trend would deserve more active recognition in Mozambique's overall investment promotion and poverty reduction strategies.

Figure 1.8: Sectoral composition of FDI, 2011



Source: Bank of Mozambique, June 2012

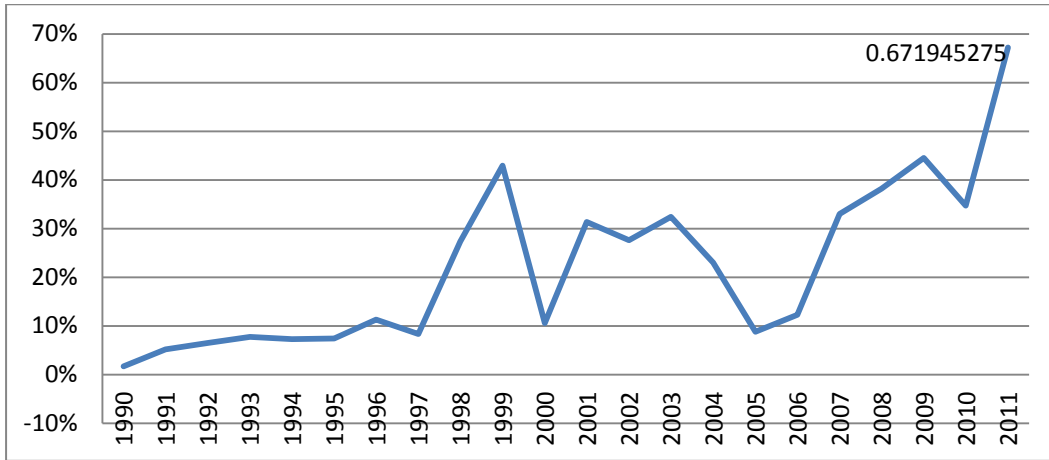
Figure 1.9: Net FDI inflows in Mozambique, 1990-2011



Source: World DataBank & UNCTAD Stat, 2012

Nonetheless for a country of 22 million inhabitants, these total FDI inflows remain modest, and the challenge of stimulating more foreign and domestic investment in the country – across all economic sectors – still looms large. In addition, the **contribution of FDI to growth** in general, and to **gross fixed capital formation** in particular, has been very variable. Over the past decade FDI has ranged from as low as 2% of GDP (USD 113 million) in 2004 to up to 70.2% (USD 5 699 million) three years later. Meanwhile the contribution of FDI to GfCF has increased from a very low base (less than 5% in 1990 and barely 10% by 1997) to much higher levels in recent years (peaking at 67% in 2011). While these ratios compare favourably against international standards, they remain very volatile, with a steep drop in 2005 (Figure 1.10).

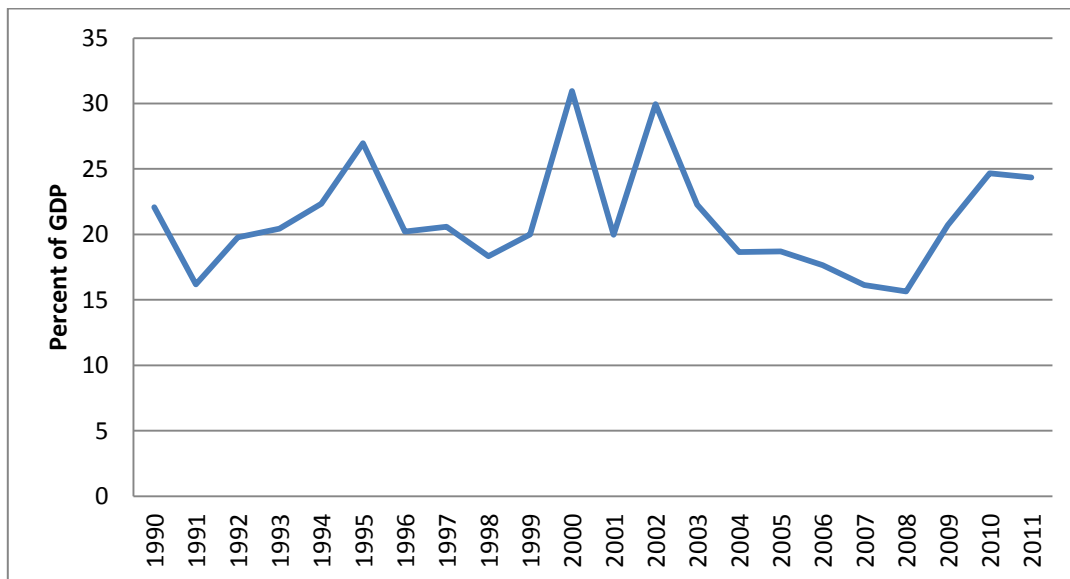
Figure 1.10: FDI inflows as a percentage of gross fixed capital formation, 1990-2011



Source: World DataBank & UNCTAD Stat, 2012

Likewise the ratio of **GfCF as a percentage of GDP** has strongly fluctuated over 1990-2011, without a consistent increase (varying between 15 and 25%, with the exception of peaks at 30% in 2000 and 2002 – Figure 1.11). These variations are in part a reflection of heavy FDI concentration in mining, and highlight the risks of relying too heavily on resource-based investment and production for foreign exchange revenues, fiscal sustainability and growth. The GfCF/GDP ratio remains close to the standard for African countries (about 21-22%) and for industrialised countries (where marginal returns to additional capital are in any case low, due to large volumes of pre-existing capital stock – about 23-25%). This ratio however falls far short of fast-growing countries in East Asia, which have reached rates as high as 40%. Such variability in GfCF limits the role of FDI as a potential source of capital accumulation, and can seriously constrain room for progress in terms of economic competitiveness and investment-driven innovation.

Figure 1.11: GFCF as a percent of GDP, 1990-2011



Source: World DataBank, 2012

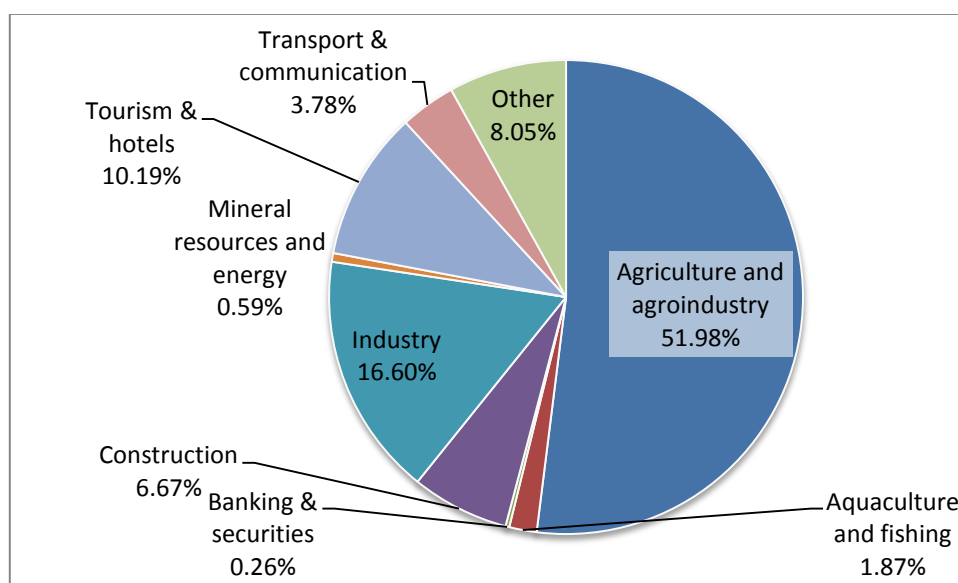
1.5 Central policy challenges

The strategy of poverty-reduction via mega-projects has met with little success

The **long-term effects of the ‘mega-project’ approach** to poverty reduction have not been clearly demonstrated so far: although large-scale projects in mining, oil and gas have certainly triggered investments in terms of energy generation and transport, the ultimate impact on employment and social development has been limited. The CPI reports that while mega-projects accounted for 72% of total capital investment over 1992-2010, they only generated 5% of total expected employment.¹⁶ As noted by UNCTAD, it is instead “FDI *outside* of mega-projects” that has so far “provided the type of developmental impact that Mozambique needs the most”:¹⁷ the CPI forecasts that recently registered mega-projects will generate only 1.7 jobs per USD 1 million invested, compared to 77 jobs for other registered projects.

Several **economic sectors outside of mining** (such as agriculture, tourism, construction and manufacturing) might therefore provide higher payoffs in terms of employment and local linkages. As Figure 1.12 indicates, agriculture, industry and tourism are among the sectors with a better track record in terms of value-addition and local employment generation (although these benefits are not necessarily automatic, as cautioned in Section 3.7 below). This strongly suggests that diversifying simply *within* the extractive sector (and therefore relying on this sector as the main stimulus for growth in other areas of the economy) might not allow Mozambique to fully reach its development and poverty alleviation objectives.

Figure 1.12: CPI-approved FDI in terms of number of staff employed (outside of mega-projects), 1992-2010



Source: CPI & UNCTAD, 2011

Insufficient investment policy safeguards

Laws and regulations dealing with investments and investors play an important role in providing for a predictable and transparent regime. In Mozambique however, the **legal framework for investment** is difficult for investors to decipher: the Investment Law of 1993 is still active but its Regulations have been replaced by the Regulations of 2009, and meanwhile several different economic sectors (including mining and petroleum) are subject to separate legislation. Moreover although several sectors of the Mozambican economy are barred to foreign participation or have limits on the size of foreign investment share-holding, there is no clear negative list of these sectors and such restrictions are dispersed in different legal

documents. Likewise investor protection safeguards (including on intellectual property rights, access to land, protection from expropriation and the resolution of disputes) exist but could be strengthened and clarified so as to enhance investors' overall protection. These safeguards are not grouped within the same legal text; nor are such laws automatically provided in their English translations on ministerial websites. The result is an investment policy framework that is insufficiently legible for investors, particularly foreign, thereby reducing investor confidence in the country. Finally, in practice the use of investment licenses as the pre-condition for accessing all benefits and guarantees provided in the Investment Law engenders discrimination between small and large investors. In investor protection as in several other domains, SMEs continue to operate on a 'tilted playing field' vis-à-vis larger enterprises.

An **efficient judiciary** is another essential component of credible investment policy safeguards. Mozambique's judiciary has been reorganised in 2007. Alternative dispute resolution is legally recognised and most cases of commercial disputes can be submitted to the Law on Arbitration, Conciliation and Mediation. However, the judicial system is still relatively weak and specialised commercial courts have not yet fully entered into force, while judges lack adequate skills. Besides, the bankruptcy process is outdated and urgently needs to be reformed. Revision of a new Bankruptcy Law has been underway for several years to date.

Prohibitive procedures for access to land

Processes for registration of land continue to pose an especially complex barrier for investors in Mozambique; recently they have also generated discussions at the local community level. Although the Land Law provides a good balance between the protection of investors and local rights, its implementation remains particularly difficult: **procedures to access land** are often poorly understood; securing the necessary investment approvals and land-use rights (DUATs) requires undertaking multiple procedures which are not streamlined within a common institution or agency (see Figures 2.1 and 2.2 in the following chapter); and procedures for community consultation and compensation (required before a DUAT can be issued) are frequently protracted and costly. Moreover payment for compensation is required before the investment and its associated revenue flows can begin, making it financially unfeasible for many investors. In addition land tenure is insufficiently secure even once the final ('definitive') DUAT is obtained, as it can be revoked – and the associated land plot reclaimed by the State – at any point if the investor is deemed not to abide by the agreed land exploitation plan.

Aside from the complex DUAT process, the **land registry and cadastre** in Mozambique remain to be considerably clarified – although the integrated e-Land Registry and Land Management Information System (LMIS) were launched in 2004 in view of digitalising national cadastre services and thereby supporting the management of Mozambican land, these necessary projects have since been hampered by insufficiently skilled human resources, unavailability of adequate infrastructure, and illiteracy on the user end.

Weak communication between public sector and investors

Persistent weaknesses in the legal and regulatory framework for investment remain in Mozambique, creating barriers for both domestic and foreign investment. In fact some recent legal reforms (such as the new Foreign Exchange Law, discussed in Section 2.6 of Chapter 2) have increased restrictiveness for certain investments, despite promoting liberalisation overall. Many of these gaps and contradictions are the symptoms of **poorly-managed communication** between public and private sectors, whereby inputs and active buy-in from the investor community on policy content and design are insufficiently sought after. As a result, important elements of the investment climate in Mozambique may not be realistically taken into consideration by the regulators, due in part to **weak feedback mechanisms** and mutual misunderstanding between public officials and private sector representatives. While the Mozambican government must be

commended for developing new policies, this insufficiently inclusive approach to policy development can lead to shortfalls in the relevance and performance of investment climate reforms.

Fiscal sustainability and desirability of investment incentives

There are ongoing discussions in Mozambique as to whether **fiscal incentives** used to attract foreign and domestic investment into large extractive-industry projects are well-designed, and avoid imposing unnecessary fiscal costs on the country (see Chapter 3). Mozambique's extractive industries have long remained largely exempt from taxation (especially at the exploration phase); nevertheless some modifications to mining and oil tax incentives have been introduced in 2009, and a new Mining Law (to be approved in the course of 2013) may introduce some taxes for investors entering the mineral production phase. In addition although Mozambique's **IFZs and SEZs** focus on attracting investment through favourable tax structures, the latter have generated few benefits for the local economy in return – often because small-scale domestic entrepreneurs lack the skills and capacity required to mobilise the potential of domestic linkages and business opportunities associated with the zones. Robust frameworks for encouraging value-addition may therefore be needed alongside, together with supply-side structural policies. So far, formal assessment of the results achieved by both fiscal investment incentives and economic zones has been minimal, and remains highly necessary.

Coherence and monitoring of investment policy

While the government has a business environment improvement strategy, there seems to be a lack of commonly agreed vision for the role of investment, both domestic and foreign, in the overall growth and development objectives of the country. Mozambique needs a clear national development strategy into which investment objectives can be embedded – one that has more vision and scope than just meeting the objectives of the country's poverty reduction strategies (the PARPA series), or the PES. Developing this wider vision would help the country ensure that improvements in the overall investment framework are most efficiently leveraged towards Mozambique's long-term development, including poverty reduction.

In this context the national investment promotion strategy (which CPI is elaborating together with other investment promotion agencies in the course of 2013) presents a good opportunity to accurately **reflect sectoral policies** and strategic investment objectives. Addressing and effectively communicating a **commonly agreed vision for the role of investment** within this document would moreover help reduce tensions as well as negative public perceptions of investment, especially foreign. The Investment Council (*Conselho de Investimento*, created at ministerial level in 2009 for the consultation and co-ordination of policies to promote and attract investments) could play an important guiding role in this regard.

On the implementation side, investment promotion efforts are hindered by a **multiplicity of agencies** with overlapping roles and unclear chains of authority (such as the CPI, CEPAGRI, INATUR, IPEX and GAZEDA). A multitude of investment promotion activities is not unusual, but governments with a track record of successful promotion have managed to establish clear co-ordination with one agency overseeing national and regional measures and efforts. Sector-specific agencies should therefore more clearly define their roles vis-à-vis CPI, and develop stronger private sector representation and sufficient political support. In order for these agencies to bring relevant inputs to the current momentum for enhanced trade and investment policy implementation, they will moreover need to be staffed and capacitated accordingly – including with the data management skills necessary for undertaking **regular monitoring** of investment policy effectiveness, which can help shore up investor confidence and identify areas most in need of reform.

Insufficient export diversification

While between 1994 and 2006 Mozambique effectively introduced 18 new manufacturing and agricultural products to its export basket,¹⁸ more steps need to be taken towards **export diversification**. Indeed, investment promotion efforts need better co-ordination with harmonised strategies for growth and export promotion in non-mining industries. Beyond expansion into extractive industries, the Government's diversification strategy must consider the need for strengthening the agricultural sector – especially given its importance for food security and employment. More attention to the tourism, manufacturing, services and construction sectors, which are also labour-intensive and have scope for value-addition, would likewise be beneficial. Given the volatility of aluminium export revenues mentioned earlier, increasing investment across these sectors would also help stabilize Mozambique's current account.

The Government has clearly begun to take these priorities on board. While Mozambique has to date lacked a clear **export promotion strategy**, the national export promotion agency (IPEX) has been elaborating such a strategy over the course of 2012 and early 2013. This forthcoming document, developed with support from the International Trade Centre and currently awaiting government approbation, will aim to encourage entrepreneurs in export industries to add more value to their investments, and to facilitate the shift from traditional commodity exports to a number of identified non-traditional sectors.

Development of such export industries will crucially depend on a dense network of enabling infrastructure and structural policies, which however remain sub-optimal (see below). In addition it will be important to ensure the alignment between this export promotion strategy and the forthcoming investment promotion strategy (mentioned above); mechanisms should be put in place to co-ordinate the work of each strategy's respective implementing agencies.

Weakly articulated infrastructure strategy

Infrastructure provides **investment opportunities** in Mozambique, especially as the country's favourable geographic location can enable it to serve as an important channel for cross-border trade and investments in neighbouring countries. Electricity sales to South Africa are a significant revenue source for the government, while transport systems like the North-South Corridor have knock-on effects on the domestic economy. However the focus on these regional infrastructure arrangements risks coming at the expense of local infrastructure provision – by themselves they will not be enough to address the dearth of local infrastructure and low access rates among the Mozambican population. Weak performance across infrastructure sectors continues to discourage large-scale domestic and foreign investment, and hampers local SME growth. Together with unskilled human capital and inadequate financing, the high cost of energy and transport infrastructure in Mozambique partly explains why SME competitiveness remains low compared to that of Mozambique's regional peers.

In addition Mozambique's infrastructure deficit is a central **bottleneck to broadening diversification** outside of the extractive industries: up to now, electricity and transport infrastructure have traditionally served the needs of mega-projects, with less regard for other industries. The stimulus role that the mega-projects have played in terms of infrastructure development is important, and should be further encouraged; nonetheless other economic sectors may suffer by contrast. Small-scale agriculture lacks the storage facilities and transport infrastructure necessary to distribute food efficiently country-wide; and the tourism industry in turn depends on high-quality air, road, and water and sanitation infrastructure for its regional and international attractiveness. As noted by the World Bank's 2009 Investment Climate Assessment (ICA) for Mozambique, only after more than 15 years of reconstruction is Mozambique's infrastructure beginning to approach the level of its regional competitors.

Insufficiently coherent strategy for development of the energy sub-sector

Although Mozambique exports electricity to South Africa, its electricity sector faces a large **transmission challenge** domestically – there is a growing gap between domestic energy demand and existing supply, which is exacerbated by the rapid expansion of the energy-intensive extractive industry sector. Mozambique’s electricity consumption has dramatically shot up since the late 1990s, coinciding with the establishment of Mozal and Mozal II (see Figure 4.2 in Chapter 4 below). The Mozal aluminium smelter alone consumes 900 megawatts, equivalent to over 70% of the total power output of the Cahora Bassa hydroelectric plant. More importantly the national approach to energy infrastructure development is insufficiently coherent, as catering to export and extractive industry needs conflicts with the supply of electricity to the domestic population: Mozal relies on energy imports from South Africa to satisfy its needs, as 80-90% of the Cahora Bassa power reaches Southern Mozambique via South African transmission lines.

1.6 Investment policy options to prioritise

The Review that follows and the recommendations that result from it outline steps through which Mozambique can not only improve its general investment climate across all economic sectors, but also render its development strategy more sustainable in terms of employment generation, value-addition and long-term industrial development. The suggested recommendations below seek to make Mozambique’s business environment more inclusive, transparent, efficient, and better-aligned with the country’s underlying development potential and human and natural resources.

Strengthen and clarify the legal framework for investment

Several fields of the investment framework need to be improved. They are summarised as follows:

- **National Treatment:** clarifying paragraph 4.2 of the Investment Law (on Equality of Treatment), which stipulates that some activities by nationals may obtain special treatment, would considerably help establishing a non-discriminatory investment climate in Mozambique. While it is fully legitimate for the government to reserve some economic activities for domestic entrepreneurs only, transparency and predictability vis-à-vis foreign investors could be improved by grouping all of these sector restrictions within a regularly updated **negative list**. This would detail all activities for which special treatment is provided to Mozambican nationals, or where foreign participation is limited to specific thresholds. As an example Mozambique could for instance look to the Bilateral Investment Treaty currently under negotiation with Japan (this Treaty, which should be concluded by mid-2013, will contain a list of sectors – especially within manufacturing – for which there will be percentage restrictions for Mozambican and Japanese ownership).
- In addition, **conditions with which investors need to comply** in order to repatriate funds are numerous and complex, which also indirectly discriminates against foreign investors. These could usefully be reviewed in the light of international best practices. Careful review of provisions of the Foreign Exchange Law may also be considered.
- **Investor Protection:** the government should also envisage clarifying the measures that are considered as national interest in cases of expropriation and nationalisation, as this would increase investor protection and hence confidence. Similarly, in case of investor-State disputes, investors should have easier access to international arbitration, and not solely upon express agreement of both parties. Most BITs that Mozambique has ratified are more flexible on this aspect, and can be a source of inspiration for possible reform of the 1993 Investment Law.

- **Investment licenses:** the scope of the Investment Law should go beyond those investors that have obtained investment licenses and apply to all investors equally. Investment licenses, while they are currently not mandatory, could either be eliminated or the processes required to obtain them reviewed and simplified (particularly in view of greater inclusiveness for SMEs).
- **Clarity, transparency and disclosure:** for clarification and coherence purposes, **all relevant regulations and laws could be gathered in a single instrument** that would bring under a single umbrella document core investment protection and promotion provisions, and provide the institutional framework for investment regulation and promotion. Such a document should also include the negative list of sectors mentioned above. Such a process of clarification would be a valuable opportunity to further engage all relevant stakeholders in an effort of coordination, consultation and consensus. Alternatively, the authorities could consider the **option of drafting an Investment Code**. Such a Code could aim to strike a better balance between elements of promotion and facilitation (which are substantially incorporated in the 2009 Regulations of the Investment Law, especially as concerns special economic zones) and equally essential core principles of investor protection.

Improve access to land and judicial enforcement

Facilitating and clarifying the **legal and administrative framework for access to land** should be envisaged by the government. This includes: increasing the effectiveness of the court system; reviving and adequately maintaining the electronic land registry and cadastre (LMIS) so as to accelerate land registration processes; and reviewing and simplifying procedures for community consultation and investor access to DUATs. The latter measure would include reducing the number of agency approvals necessary for obtaining the DUAT (see Figures 2.1 and 2.2 in the following chapter), and possibly reviewing the distinction between a provisional and a definitive DUAT (which essentially requires the lengthy approval process, with all of the agencies and costs that it involves, to be repeated on two separate occasions). Moreover **security of land tenure** would need to be considerably reinforced – in particular the definitive DUAT provides little protection from expropriation: the land right can be revoked at any time during the 50 years of DUAT validity, should the investor no longer abide to the initial land exploitation plan. A more flexible and secure approach to land tenure would enhance incentives for domestic and foreign entrepreneurs to engage in long-term land improvements, and would also increase land registration rates. The recently-established Land Consultative Forum could be a suitable venue for actively pushing such reform forward.

More broadly, an important push on **law enforcement** is needed. While this can take the form of accelerating ongoing reforms, such as the Bankruptcy Law, the government has a number of other options available to increase confidence among investors. For example, while wider efforts to increase the effectiveness of the court system (such as online arbitration to reduce time taken) need to be launched, the proper implementation and use of commercial courts – with well-trained judges – could be a useful ingredient to boost investor confidence. In addition, Government could take concrete measures to improve the transparency and availability of investment-related laws (many of which are difficult to obtain and are only available in Portuguese). Article 2.6 of the Bilateral Investment Treaty (BIT) signed by Mozambique with Uganda provides an interesting provision on the obligation to **publicly disclose all investment-related laws, regulations and administrative procedures**. This provision should be a general one in Mozambique’s broader investment framework to support its effective implementation.

Streamline the institutional structure for investment policymaking, as well as for investment promotion and facilitation

On the policymaking front, stronger national-level guidance in terms of a long-term investment vision and strategy is clearly needed in Mozambique, which the **Investment Council** would be well-placed to

provide. However since its creation in 2009, this Council has yet to meet its full potential. A clearer structure of authority and responsibilities would need to be specified in order to facilitate and guide investment policy reform; specific reference to the Council and to its powers relative to other policymaking and implementing bodies (various ministries, but also investment promotion agencies such as GAZEDA and CPI) could be incorporated in national legislation. Although Article 4 of the 2009 Investment Regulations introduces a necessary clarification of “Competency for the coordination of investments”, this therefore remains an insufficient step forward. Empowering **inter-ministerial committees** could also accelerate policymaking and implementation, especially for elements of investment policy that cut across the domains of different ministries.

On the investment facilitation front, specialised **investment promotion agencies** like INATUR (tourism), CEPAGRI (agriculture) and IPEX (for all exports) should play a more active role in promoting private investment in their respective sectors, and their collaboration with CPI should be better coordinated or rationalised. This includes better informed consultative mechanisms; the **investment promotion and export promotion strategies** under elaboration over 2012-2013 (respectively under CPI and IPEX leadership) present particularly good opportunities for formalising such structures. These could subsequently be put to use for the joint implementation and monitoring of associated investment and export promotion activities. Lessons learned from successful and innovative investment promotion efforts in specific sectors (such as the Mozambique Tourism Anchor Investment Programme, concluded in 2011) could notably be consolidated at the level of each specialised investment promotion agency, and then relayed to a common dialogue platform involving CPI, IPEX and the Investment Council, so as to feed in to a coherent sector-wide approach for export competitiveness and investment attractiveness.

‘Target’ industries and stakeholders should be actively involved in the elaboration and implementation of both of these national strategies. **Capacity shortcomings** in institutions undertaking investment promotion should also be addressed if promotion at sectoral level is to be effective and genuinely upgraded. In order for these agencies to bring relevant inputs to the current momentum for developing and implementing trade and investment strategies, they will notably need to develop stronger private sector representation and sufficient political support, and also to acquire the data management skills necessary for **regular monitoring** of investment policy effectiveness. Progress on both of these fronts would facilitate public-private dialogue on investment policy, help identify policy areas most in need of reform, and ultimately shore up investor confidence.

Establish a mechanism for regular and systematic cost-benefit analysis of investment incentives, both for tax structures and accelerated economic zones

While fiscal reforms in 2009 have been a good first step to simplifying the tax system, continued efforts need to be made in order to better share resources from mineral exploitation and to put SMEs on a more equal footing with other investors. A mechanism for **systematic cost-benefit analysis** of investment incentives would support the Government in moving its tax reform agenda forward by highlighting the resources that are lost to ineffective fiscal exemptions, and would reduce the transaction costs faced by the tax administration and associated with managing multiple derogatory systems. The relevance and appropriateness of incentive strategies should be examined at regular intervals, possibly by the authorities responsible for delivering these incentives, which could then report to the Ministry of Finance. Such evaluations should measure the economic benefits of investment incentives against their budgetary and other long-term costs. These assessments (both ex ante and ex post) should involve open public consultation so as to accurately include social – and not only financial – costs and benefits in the analysis.

This assessment of incentives would notably allow an in-depth evaluation of the operations and achievements of **SEZs and IFZs**, in view of improving or restructuring them to enhance their potential in terms of value-addition and generating local economies of agglomeration. Government should also consider the **alternatives to investment incentives** – that is, whether forgone fiscal revenues sacrificed for

incentives may better be used for enhancing structural policies (geared at education, infrastructure and so forth – for instance through the Technical and Vocational Education and Training system) that could increase investment attractiveness.

Support effective implementation of a comprehensive export promotion strategy

The export promotion strategy currently under finalisation by IPEX will be an important step towards facilitating the growth of non-traditional export sectors. The strategy should notably give due attention to undervalued economic sectors that have high employment potential – such as niche markets within agriculture, tourism, construction and manufacturing. It should also propose targeted measures for allowing SMEs to tap into these export markets, including by suggesting measures for building investment and trade linkages, and by providing clear export guidance for domestic firms. Such a strategy and its alignment with investment policy, the private sector development strategy, and overall national development goals would allow Mozambique to **capitalise on its sectoral advantages** and better achieve its diversification and job creation objectives.

It is essential that the authorities responsible for elaborating this strategy operate in **close collaboration with bodies responsible for investment policy design**, given the very strong links between investment and trade. Given that Mozambique is concurrently elaborating a national investment promotion strategy (through CPI), it may be desirable to establish a common task-force for the joint finalisation of both strategies. This taskforce could co-ordinate inputs from the private sector as well as from other relevant government bodies (such as those responsible for human resource development and for the country's infrastructure master-plans). Equally importantly, it could set the groundwork for co-ordinating and monitoring the implementation of both strategies once they are being operationalised.

Balance domestic and strategic needs in infrastructure (and especially energy) development

While maximizing the potential of infrastructure as an enabler of growth, Mozambique will need to balance its regional and large-scale consumer needs with those of other domestic infrastructure users. With this objective in mind, Mozambique could formulate a long-term strategy for energy development to succeed the Energy Sector Strategic Plan 2010-14 that focuses on extending access to infrastructure services. The government should especially exploit the opportunities presented by mega-projects by providing incentives for mining companies to extend the infrastructure systems they will build to cover areas not immediately related to their mining activities. More broadly, **infrastructure investments by mining companies** (which are set to expand yet further with Mozambique's growing coal boom) should be **carefully co-ordinated by Government so that they contribute to a coherent national framework**. Rather than being undertaken by individual companies in isolation and each according to its own needs, infrastructure projects would thus build on joint economies of scale, while simultaneously addressing the population's requirements and tackling gaps in the national network. Road and rail transport, as well as energy provision, are infrastructure sub-sectors where this co-ordinated approach would be particularly beneficial.

Also in view of greater end-user accessibility, a **decentralised strategy** for power provision would be well-suited to Mozambique's dispersed population. Mozambique has already made use of decentralised solutions and community-based operations to expand service provision in water and telephone services (especially for rural areas), and this approach can be scaled up as well as applied in the power sector. **Community-managed projects** are promising, as the examples of self-generation from natural gas in a number of towns in Inhambane illustrate. With government support and private sector involvement, community initiatives can be scaled up and help fill the capacity gap at national level. The government can make use of management contracts with private companies for water service provision or for small-scale power projects, especially in clean energy, so that they can perform the functions normally carried out by

utilities in urban areas. In the energy and water sectors, private sector-led off-grid solutions to developing energy infrastructure could be promoted.

Encourage the growth of the renewable energy sector

The government should expand the scope of its energy projects to include wind, solar and biomass generation in addition to hydropower. **Policies to promote renewable energy** in Mozambique, such as the Biofuels Strategy, should be harmonized with rural development and environmental policies to maximise their impact. Feed-in tariffs for wind, solar, biomass and hydropower generation can also help draw in private investment, if these are sustainable for the Government and if adequate phasing out strategies are provided for. The government can also consider lifting duties on the import of “green goods” such as solar panels to encourage renewable energy generation. Attention must nonetheless be taken that new hydropower projects do not cause undue damage to the environment, especially with dam construction. Public consultation, resettlement and compensation schemes will need to be considered. Finally the government may want to consider giving preference or a **greater allocation to domestic users** instead of neighbouring countries for conventional and renewable energy projects currently in the pipeline.

Strengthen the framework for private participation in infrastructure

Mozambique needs to strengthen the **regulatory framework for procurement and PPPs** in infrastructure. The 2012 Regulations for the Law on PPPs, Large-Scale Projects (LSP) and Business Concessions (BC) and the establishment of a PPP Unit are good steps in this regard. Moreover should Government move forward in its consideration of a law for small-scale and municipal PPPs (which could unlock important investment opportunities for decentralised infrastructure provision, as mentioned above), this should be done in careful consideration of the project management and financial capacities of local governments. A simpler arrangement for PPP oversight, instead of the current four-agency approach, should also be considered to reduce bureaucracy. Relevant **sectoral regulators** should moreover be better empowered not only for the accurate pricing of infrastructure services, but also in terms of monitoring project implementation – so as to avoid missed performance targets and contractual conflicts. For example, although in 2006 the government put in place a strategy to transform the National Electricity Council (CNELEC) from an advisory body into a fully independent regulator with final decision-making authority, this unfortunately still remains a work in progress.

Increase competition in the power sector

As the government plans to implement its priority energy projects, it should create a level playing field for all actors to compete, notably through revising special privileges enjoyed by **state-owned enterprises** across infrastructure sub-sectors. Mozambique’s Competition Authority (which was set up in 2012) will also have a role to play in this regard. In the power sector, a first step might be to create more space for independent power provision (IPP) by establishing standard Power Purchasing Agreements (PPAs) between the monopoly ‘single buyer’ (EDM) and private electricity providers. A framework could for instance be put in place to encourage IPPs to secure electricity generation licences, while standard off-taker agreements would provide greater assurance that tariffs will be stable or that IPPs will receive a minimum return on their sales. This would enhance the predictability and attractiveness of the electricity market for private actors, as opposed to the current approach whereby generation contracts are negotiated on a case-by-case basis.

At a later stage, government could also consider further **unbundling the sector** and allowing for private investment outside of the generation segment alone (that is, moving beyond the ‘single-buyer’ model and introducing competition in electricity transmission and distribution as well). In this view, corporatisation of electricity utilities, including creating business lines and performance-based incentives

for staff, could help identify where profits and losses are made, and therefore which services would be left to the private sector. A similar approach could also be considered in the water sector.

Better design concessions as well as regional infrastructure contracts

Better **packaging of infrastructure projects** is necessary in order to attract private contractors and address Mozambique's significant national infrastructure investment needs. The government can consider a package model for transport concessions or electricity generation agreements, for example by inviting private contractors to develop both a main road and a secondary feeder road at the same time. During the tendering process, Government should consistently provide all policy and project documents in both English and Portuguese to capture a wider spectrum of investors. The multiple procurement systems in use, especially with donors, must be rationalised to enhance transparency and efficiency in infrastructure construction and service provision. On the regional front, while it may be difficult to revise long-standing regional power purchase agreements such as with Eskom in South Africa, Mozambique can take measures to ensure that future agreements with its neighbours have **clauses for their periodic revision**.

Undertake targeted supply-side efforts for business linkage development

Efforts to enhance local industry linkages with large-scale investment have had limited success so far. In the extractive industries, these linkage efforts rely mostly on voluntary private-sector-led initiatives – while these can have significant impacts, a system of **structured government support** would be useful for further encouraging them and extending them to more companies. Development agreements established with extractive companies could usefully consider national infrastructure development schemes. In coal mining for instance, the government could encourage mining companies to extend their infrastructure systems to include areas not immediately related to their mining activities. Targeted linkage programmes could also be extended to more labour-intensive sectors (such as agriculture or tourism) where employment creation and value-addition can be much higher.

Systematically gather investor feedback in view of monitoring the impact of investment policy measures

The content, organisation, leadership and delivery of the business environment improvement strategy should be assessed objectively against the needs of investors and consumers in Mozambique. Establishing systematic feedback mechanisms with investors and the public would result in better-targeted and stronger policies. Through widespread consultation in both public and private sectors, the Investment Council could help better embed investment objectives within Mozambique's national development strategy, and prepare corresponding **output and outcome indicators** together with time-bound steps for implementation of reform. Structuring more constructive and regular communication with the umbrella private sector group, the Confederation of Business Associations (CTA) would also allow greater ownership of the reforms by the first concerned (investors).

Establish an SME task force to review the practical needs of the sector

Building on policy and institutional initiatives, a **task force involving SMEs** could be set up to assess their needs across all economic sectors, with regards to national investment-related policies. This could build on or increase the capacity of the Institute for Small and Medium Enterprises (IPEME). Ministries, supported by CPI and IPEME, should shape a strategy that ensures that small investors are better-represented in inter-ministerial processes for investment policy design and implementation. Indeed greater communication and exposure of the needs of SMEs is required across fields of economic policymaking. Removal of the CPI investment license, or revision of the license threshold with a view to reducing the bias against smaller enterprises, also remains necessary to ensure that SMEs retain access to the same level of protection and benefits as do larger investors.

Sector-specific efforts may also be necessary, given that SME needs vary by industry and are more accentuated in certain sectors. The forthcoming investment and export promotion strategies could be an appropriate venue for better integrating SME concerns – especially as regards the promotion of more labour-intensive economic sectors. This would need to go hand-in-hand with enhancing access to finance and further simplifying tax requirements for SMEs.

1.7 Addressing these challenges in the context of an OECD Investment Policy Review

Box 1.1: The OECD Policy Framework for Investment

The Policy Framework for Investment (PFI) was developed to help governments “mobilise private investment that supports steady economic growth and sustainable development, and thus contribute to the prosperity of countries and their citizens and the fight against poverty” (PFI Preamble).

Inspired by the 2002 United Nations Monterrey Consensus on Financing for Development, which ascribes to governments the responsibility for creating the right conditions for private investment to flourish, the PFI aims to support development and the fight against poverty and to promote responsible participation of all governments in the global economy.

The PFI represents the most comprehensive multilaterally-backed approach to date for improving investment conditions. It addresses some 82 questions to governments in 10 policy areas to help them design and implement good policy practices for attracting and maximizing the benefits of investment. The PFI is based on the common values of rule of law, transparency, non-discrimination, protection of property rights in tandem with other human rights, public and corporate sector integrity, and international co-operation for development.

Several countries participated in developing the PFI, including some 30 OECD and 30 non-OECD governments. Business, labour, civil society, and other international organizations, such as the World Bank, also played an active role, and regional dialogue and public consultations were organized around the world. The PFI was endorsed by OECD ministers in 2006, when they called on the OECD to continue to work with non- member governments and other inter-governmental organizations to promote its active use. Already, Morocco, Indonesia, China, India and Zambia are some of the countries that have undertaken a self-assessment of their investment framework based on the PFI. Moreover the Southern African Development Community (SADC) has decided to develop its Regional Investment Policy Framework using the OECD PFI as its reference.

The subsequent chapters of this review therefore represent the Government of Mozambique’s self-assessment based on the OECD PFI. Based on analysis of what sectors would most benefit from reform and best stimulate the rest of the investment environment (as explored in the preceding overview), the Ministry of Planning and Development (MPD) of Mozambique decided to focus on three distinct policy areas of the PFI: investment policy; investment promotion and facilitation; and infrastructure development. They are covered by Chapters II, III and IV, respectively.

Source: www.oecd.org/investment/pfitoolkit.

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